NOTES

BOND INVESTMENTS BY NATIONAL BANKS

Paragraph seven of the national banking law provides that any such association shall have power to "Exercise by its Board of Directors or duly authorized officers or agents subject to law all such incidental powers as shall be necessary to carry on the business of banking; by discounting and negotiating promissory notes, drafts, bills of exchange, and other evidences of debt." Two very strong decisions of the United States Supreme Court have held that no power is given under this section to buy stocks in any corporation,[1] and there are a number of decisions to the effect that no national bank may purchase or hold the stock of any other national bank.[2] The court has conceded that national banks may buy unmatured coupons detached from bonds[3] but has never fully passed upon the right of national banks to purchase for investment any bonds other than those of the United States. But in *California Bank* vs. *Kennedy*[4] that court held: "It is settled that the United States Statutes relative to national banks constitute the measure of the authority of such corporations and that they cannot rightfully exercise any powers except those expressly granted or which are incidental to carrying on the business for which they are established." And in *First National Bank of Charlotte* vs. *National Exchange Bank*, 92 U.S. 122, 125, the court says: "The eighth section of the law enumerates the powers which a national bank can exercise. Every other power is as much withheld as if it were in express terms prohibited." Pratt's *Digest of Laws Relating to National Banks* says: "A national bank has no power to deal in stocks and bonds or buy and sell them upon commission. Such operations are not incidental to the business of banking as defined in the Statutes." Several decisions of state supreme courts, as well as of United States courts, hold

[1] *California Bank* vs. *Kennedy*, 167 U.S. 362; *First National Bank* vs. *National Exchange Bank*, 92 U.S. 122; *First National Bank of Ottawa* vs. *Converse*, 200 U.S. 425.

[2] *Shaw* vs. *National German-American Bank of St. Paul*, 199 U.S. 603; *Concord First National Bank* vs. *Hawkins*, 174 U.S. 364; *Chemical National Bank of New York* vs. *Havermale*, 120 Cal. 601.

[3] *First National Bank* vs. *The Town of Bennington*, 16 Blatchford 53.

[4] *California Bank* vs. *Kennedy*, 167 U.S. 362.

most positively that national banks have no power to buy and sell stocks and bonds upon commission or even to buy them to sell again.[1]

Under such decisions it would naturally be supposed that dealings by banking institutions in securities or bonds would be confined to state banks or trust companies. But on the contrary almost every bond-buying syndicate that is formed comprises national banks among its members, and testimony before the Pujo "Money Trust" Committee showed that national banks were even interested in the syndicate which marketed the stocks of the California Petroleum Company.

With such lax interpretations of the banking laws, notwithstanding the positive decisions of different supreme courts, it would not be strange if many national banks, observing the vast transactions in bonds and securities by certain well-known banks in New York and other cities and the immense profits made thereby, should also become large buyers of bonds. But the great extent to which that practice has been carried by national banks and its very rapid development in the last few years has not been generally known and is certainly worthy of the most careful attention and investigation.

Aside from ownership of United States bonds, which such banks have full authority to deal in, the last report of the Comptroller of the Currency shows that the national banks held on June 14, 1912:[2]

State, county, and municipal bonds	$ 179,322,004
Railroad bonds	354,321,271
Other public service corporation bonds	195,452,530
All other bonds	223,500,814
Stocks	43,097,143
Bonds of foreign governments and other foreign securities	13,041,319
Warrants, judgments, and other securities	69,047,920
Total	$1,077,783,001

At the same time the aggregate capital stock of all national banks was $1,046,012,500.

The increase in these holdings of securities has been very rapid and entirely out of proportion to the growth of capital, deposits, or loans.

[1] *Wickler* vs. *First National Bank of Hagerstown*, 42 Md. 581; *Smith* vs. *Philadelphia National Bank*, 1 Walker (Pa.) 318; *Searle* vs. *First National Bank*, 2 Walker (Pa.) 295; *First National Bank of Allentown* vs. *Hoch*, 89 Penn. 324; *Farmers and Merchants National Bank* vs. *Smith*, 23 C.C.A. 80.

[2] *Report of the Comptroller of the Currency*, 1912, p. 16.

This may be seen by the following comparisons of growth from September 1, 1909, to June 14, 1912:

Increase in aggregate capital stock	10.06 per cent
Increase in aggregate individual deposits	17.59
Increase in loans and discounts	17.76
Increase in holdings of securities other than United States bonds	41.63
Increase in holdings of securities other than United States, state, or municipal bonds	48.57

The holdings of the last class of securities increased from $604,757,738 in 1909, when they represented 64 per cent of the aggregate capital, to $898,460,997 in 1912, which was 87 per cent of the aggregate capital.

Not only has this constant and disproportionate increase in the holdings of securities been taking place, but at the same time the class of bonds held has been changing. Thus in 1909, 65½ per cent of the holdings were state, municipal, and railroad bonds, but in 1912 those issues comprised only 49½ per cent of the total, while holdings of public service corporations and other bonds, stocks, and securities had increased from $397,397,815 in 1909 to $531,098,407 in 1912, an increase of $133,700,592. As many of the latter class have a less fixed market value and were evidently purchased in preference to the more standard state, municipal, and railroad issues because of higher interest rates, the change is unquestionably not beneficial either to the depositors of the banks or to the public.

A careful examination of the detailed reports made by the various banks to the Comptroller of the Currency shows the vast extent to which this custom of bond-buying by the banks has developed. In June, 1911, out of a total of 7,301 national banks, 2,211, or over 30 per cent, held bonds and securities, other than government bonds, for more than their capital stock. In 1,222 banks such holdings amounted to more than 200 per cent of their capital; in 649 banks they were over 300 per cent, in 371 they were over 400 per cent; 213 banks held over 500 per cent, 133 held over 600 per cent, 81 held over 750 per cent; 17 banks held such securities to more than ten times their capital and two banks had over twenty times their capital thus invested.

As a natural result of these large security holdings a great portion of the deposits are thus invested. In 353 banks such securities equal 60 per cent of the deposits; in 108 banks the amount is 75 per cent. Quite a number of banks have holdings of such securities equaling or exceeding

EXAMPLES OF THE AMOUNTS OF SECURITY HOLDINGS OF CERTAIN NATIONAL BANKS*

Bank	State	Capital	Deposits	Loans	Securities Owned
1....	Delaware	$ 25,000	$ 232,666	$ 17,915	$ 223,694
2....	Maine	60,000	1,581,493	631,136	738,186
3....	Maryland	50,000	643,031	192,062	568,188
4....	"	100,000	3,238,060	1,686,365	1,455,270
5....	Massachusetts.....	25,000	114,201	16,070	102,403
6....	New Jersey	100,000	532,802	53,026	579,882
7....	" "	25,000	353,750	113,167	257,343
8....	" "	200,000	3,217,552	1,266,978	1,800,824
9....	" "	200,000	4,014,834	1,385,538	2,232,868
10....	" "	150,000	3,192,801	1,199,135	1,806,025
11....	" "	150,000	2,415,294	927,256	1,515,637
12....	" "	100,000	1,529,628	539,330	1,080,712
13....	" "	50,000	871,210	283,529	559,071
14....	" "	50,000	808,953	121,181	828,890
15....	New York	10,000,000	116,223,312	59,762,281	48,501,146
16....	" "	100,000	2,068,668	217,454	1,712,282
17....	" "	50,000	243,670	32,034	218,509
18....	" "	200,000	3,122,894	921,220	2,049,205
19....	" "	100,000	1,710,274	497,292	1,134,553
20....	" "	100,000	3,083,226	731,329	2,160,431
21....	" "	100,000	3,155,973	1,750,279	1,284,407
22....	Pennsylvania	110,000	2,037,179	267,100	1,926,734
23....	"	105,000	1,123,458	199,276	938,990
24....	"	50,000	1,257,598	142,334	1,074,700
25....	"	100,000	1,805,936	554,801	1,123,180
26....	"	150,000	1,526,999	456,327	1,166,856
27....	"	25,000	249,470	56,139	180,760
28....	"	25,000	268,560	51,233	213,340
29....	"	100,000	1,883,241	805,429	1,059,903
30....	"	100,000	1,025,328	232,945	1,024,938
31....	"	1,000,000	10,576,477	5,354,968	6,102,406
32....	"	75,000	484,180	127,431	346,755
33....	"	150,000	2,542,082	1,041,800	1,499,500
34....	Wisconsin	150,000	2,345,014	1,461,849	720,786

* The figures in this table are, in all cases, taken from the reports of banks in the *Report of the Comptroller of the Currency*, 1912, pp. 444–60. It has, however, seemed best to omit the names, and to represent each bank by a number.

their deposits. This also interferes with their loaning ability, the banks apparently having found greater profits heretofore in dealing in bonds rather than in making loans or discounts although discounting is unquestionably the first function of a commercial bank of deposit. In 1037 banks these securities were held to an amount equaling 50 per cent of their loans. In 740 banks the security holdings equaled 75 per cent of the loans, in 359 they equaled the loans, in 103 they were 200 per cent of the loans, and in a number of cases they were five to ten times as large as the loans. Beyond any doubt this great locking-up of the funds of

these commercial banks in such securities rather than their use in loans to customers or other business men has had much to do with the frequent stringency of the money markets in late years.

SOME OF THE SECURITIES OWNED BY ONE NATIONAL BANK*

Name	Character	Amount
Booth Fisheries Co.	6% bonds	$3,066,000
Cumberland Corporation	5%	1,238,000
Distilleries Securities Corporation	5%	1,627,000
Lackawanna Steel Co.	5%	240,000
Lehigh & Wilkesbarre Coal Co	4%	1,057,000
Old Dominion Development Co.	6%	150,000
Procter & Gamble Soap Co.	5%	85,000
Saõ Paulo, Brazil	5%	2,000,000
Southern Power Co.	5%	300,000
United States Steel Co.	5%	252,000
Virginia Power Co.	5%	617,000
Union Bag & Paper Co.	5%	260,000
Westchester Lighting Co.	5%	560,000
Wabash-Pittsburgh Terminal Co.	5%	290,000
Allied Machinery Co.	Stock	500 shares
Chicago Elevated Railway Co.	Preferred stock	553 "
Alliance Realty Co.	Stock	100 "
Central Hudson Steamboat Co.	Common and preferred stock	180 "
United Realty Co.	6% bonds	$ 600,000
United States Realty Co.	5% bonds	115,000

*This list of securities is contained in the statement made by the bank in question to the Pujo "Money Trust" Committee.

As the banking law does not authorize and probably never at any time contemplated these large holdings of securities by national banks, no restriction as to the class of securities bought is provided in the laws. In almost all states savings banks are very strictly limited in the character of their investments. A mere glance at the statement of bonds owned by the national banks plainly shows that a very large proportion of them are securities of a class which no savings bank or life insurance company is permitted to own and which are certainly not suitable for a bank, a great proportion of whose deposits are payable on demand. For a very large part of these securities the market must be a limited one. Aside from state, municipal, or railroad bonds, only a small part of the $531,098,407 of other securities owned are quoted on any exchange. To a considerable extent the securities would probably be difficult to sell in times of financial trouble.

But even the best of these securities are open to another serious objection. The rise of interest rates during the last few years has shown

itself most forcibly in declines in value of even the highest classes of bonds. A compilation of the prices of 52 of the choicest bonds quoted on the New York Stock Exchange shows how great and general this decline has been. The average price of 9 foreign government, state and city bonds was $99\frac{1}{4}$ per cent in 1909 as against 94 per cent today. That of 9 telegraph, telephone, and old industrial issues was $98\frac{1}{2}$ per cent in 1909 and is 93 per cent today. The average price of the 28 leading issues of railroad bonds, all first mortgages of the largest roads, has in the same time declined from $96\frac{1}{4}$ per cent to $87\frac{5}{8}$ per cent, or $8\frac{5}{8}$ per cent loss. But even that does not measure the decline. The average fall in the first mortgage $3\frac{1}{2}$'s of the Chicago & Northwestern, New York Central, and Lake Shore Railroads, and in the 4's of the Chicago, Milwaukee & St. Paul and the Great Northern has been $9\frac{3}{8}$ per cent. These are all the choicest of bonds, dealt in on the exchanges of the United States and Europe. As has been shown, the larger portion of the bonds and securities held by the national banks possess no such market and their ready sale is questionable under present conditions.

But even on the basis of the decline in the choicest railroad issues the fall in values has been sufficient practically to wipe out the capital of probably 250 of the banks and very materially to impair that of some 400 others. Yet it is impossible to predict whether prices have reached bottom. The same decline in prices has been felt by the English banks and the only failures there of consequence have been caused by such declines. But for a number of years, since this movement began, it has been the custom of English bankers to charge off each year the year's decline in value on securities held and thus preserve their capital intact. There is an imperative necessity for such practice by American bankers and it would seem the duty of the Comptroller of the Currency to require it in national banks.

Some attention has been called to the condition of savings banks holding investments in bonds and doubtless action should be taken by them to keep their reserves intact. But the condition described in national banks demands even more attention. The savings banks have large proportions of their funds invested in real estate mortgages which an increase in general interest rates makes even safer without in any manner impairing the principal. Moreover, saving deposits generally remain untouched for long periods and can be withdrawn only on considerable notice. But national bank deposits as a rule are withdrawable on demand. Despite this fact, more than 350 banks, as has been shown, have over 60 per cent of their deposits invested in these securities.

Such a situation is one demanding governmental action. Among the recommendations of the Pujo "Money Trust" Committee was one for a law limiting the proportion of the assets which a national bank might invest in this class of securities. Very probably some such legislation will be passed at this congressional session. But in view of the questionable legality of these investments and the pressing necessity for a change in such banking methods, the Comptroller of the Currency should be in position to take speedy action which would at least place some restriction upon this rapidly growing tendency of the national banks, especially in the eastern and central states, to tie up so large a proportion of their funds in investments which were evidently not contemplated by the national banking law and which materially limit the ability of the banks to care properly for their commercial customers.

JOHN V. HOGAN

NEW YORK CITY

WASHINGTON NOTES

BUSINESS AND THE TARIFF

The final action of the President in signing the tariff bill on October 3 is too recent to admit of absolute predictions concerning the effect of the measure, but even since the law went into effect some very interesting trade and international developments have taken place. These have been almost entirely against the preconceived views of those who attempted to forecast the influence of the tariff upon business.

Perhaps the most striking feature of the situation has been seen in the circumstance that withdrawals of goods from bonded warehouses—or in other words actually effective importations—have been very much smaller than had been thought likely. There has been an increase in the total amount of import duties as compared with the corresponding period last year, which indicates that at the lower rates of duty imposed by the act, the volume of goods, measured in terms of value, has been somewhat larger. This, however, has been thus far only a relatively minor advance. Even prior to the passage of the act, the total quantity of goods in warehouse was only about $15,000,000 or $20,000,000 larger than normal, taking the country as a whole. But even this quantity of additional goods has not been withdrawn from warehouses as speedily as some domestic manufacturers supposed it would be. Several reasons can be given for this relative slowness on the part of the tariff bill in changing the economic outlook. One is that the reduction of duties is